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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)	
)	
1998 Biennial Regulatory Review –)	CC Docket No. 98-137
Review of Depreciation Requirements)	
for Incumbent Local Exchange Carriers;)	
)	
Ameritech Corporation Telephone)	CC Docket No. 99-117
Operating Companies' Continuing)	
Property Records Audit, et. al.;)	
)	
GTE Telephone Operating Companies)	AAD File No. 98-26
Release of Information Obtained)	
During Joint Audit.)	

INITIAL COMMENTS OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Pursuant to Sections 1.49, 1.415, and 1.419 of the Federal Communications Commission's ("FCC" or Commission) Rules of Practice and Procedure, 47 C.F.G. Section 1.49, 1.415, & 1.419 (), the National Association of Regulatory Commissioners ("NARUC") respectfully submits these comments on the FCC's Further Order of Proposed Rulemaking adopted March 31, 2000, and released April 3, 2000 {FCC 00-119} in the above-captioned proceeding.

In support of these comments, NARUC states as follows:

I. NARUC's Interest

NARUC is a quasi-governmental nonprofit organization founded in 1889. Members include the governmental bodies engaged in the regulation of carriers and utilities from all fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands.

NARUC's mission is to improve the quality and effectiveness of public utility regulation in America. Specifically, NARUC is composed of, inter alia, state and territorial officials charged with the duty of regulating the telecommunications common carriers within their respective borders. These officials have the obligation to assure that such telecommunications services and facilities as are required by the public convenience and necessity are established, and that services are furnished at rates that are just and reasonable.

Because of the potential impact on state commission procedures, and NARUC's stated goal of promoting more efficient regulation, NARUC has an interest in this proceeding.

II. Background

In its Report and Order in CC Docket No. 98-137 and Memorandum Opinion and Order (Depreciation Order) in ASD 98-91, adopted on December 17, 1999 and released December 30, 1999, the FCC adopted additional streamlined procedures for depreciation and concluded that a waiver of its depreciation prescription process may be appropriate when an Incumbent Local Exchange Carrier (ILEC) (1) adjusts the net book value costs on its regulatory books to the level

currently reflected in its financial books by a below-the-line write-off; (2) uses the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) foregoes the opportunity to seek recovery of the write-off through a low-end adjustment, an exogenous adjustment, or an above-cap filing; and (4) agrees to submit information concerning its depreciation plant accounts, including forecast additions and retirements for major network accounts and replacement plans for digital central offices and information concerning relative investments in fiber and copper. These conditions were concluded to be necessary to ameliorate any harmful impact that unrestricted changes in depreciation expenses could have on consumers and competition. Further, because of concerns of the impact new depreciation methods will have on resulting costs in the models for the determination of universal service high cost loop support and of interconnection and unbundled network element (UNE) rates, the FCC proposed continuation of their ranges of depreciation lives and salvage factors. These factors would be input data for model runs to determine high cost support, and interconnection and UNE prices. The Depreciation Order also invited alternative proposals by carriers seeking a waiver of depreciation requirements but cautioned that such proposals must provide the same protections to guard against adverse impacts on consumers and competition as the four conditions set forth above.

Subsequently, on March 3, 2000 the Coalition for Affordable Local and Long Distance Service (CALLS) submitted an alternative proposal to the FCC to eliminate the existing disparity between the regulatory and the financial accounting for depreciation expense and associated reserve balances over five years. The proposal included an intent of the CALLS participants to file a joint request for waiver of the FCC's depreciation requirements to (1) propose to use the same

depreciation factors and rates for both Federal regulatory and financial accounting purposes, and (2) commit to submit, under a request for confidentiality, information concerning their depreciation accounts when significant changes to depreciation factors are made. Additionally, the proposal included a five-year amortization, to begin with and be contemporaneous with the timing of the CALLS access charge/universal service reform proposal, of the difference between the regulatory reserve balances and the corresponding external financial reserve balances. The amortization expense would be an above-the-line expense. However, the amortization would have no effect on interstate price caps or interstate rates and the carriers commit not to seek recovery of the amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing. Further, the carriers commit not to seek recovery of the interstate amortization expense through any action at the state level, including any action on UNE rates.

The FCC seeks comments on its proposed rulemaking to evaluate the conditions under which the existing depreciation rules may be eliminated or changed for all price-cap carriers.

III. DISCUSSION

The NARUC appreciates the opportunity to offer comments on this FNPRM. First and foremost, the NARUC agrees with the conclusions in the decision in Depreciation Order. Additionally, we believe that the proposal of the ILECs in the CALLS, with minor modifications, could meet the criteria set forth in the Depreciation Order. However, we notice that the FNPRM would relate to all price cap ILECs rather than just the CALLS ILECs. Since the commitments made by the CALLS ILECs are not necessarily commitments of other price cap ILECs, FCC should ensure

that the criteria set forth in the Depreciation Order is required for all price cap carriers before the carriers are given the same treatment proposed by the CALLS ILECs.

Amortization of Financial/Regulatory Reserve Differences

When the ILECs adopted the discontinuation of application of FASB Statement No. 71 and elected to use shorter depreciation lives for reporting their operations in their financial statements, a difference in the reserve position was created. A credit to the reserve and a debit to an extraordinary below-the-line charge reflecting the effect of shorter plant lives created this difference.

To parallel the original accounting that set up the difference in the reserve positions on the financial books and to eliminate an unnecessarily complex administrative five year amortization period on the regulatory books, the NARUC believes a one-time charge below-the-line on the regulatory books should be required to effectuate a move from regulatory oversight of depreciation to reliance on financial depreciation practices. Additionally, this write-off represents a one-time non-recurring adjustment, which, by definition, is typically recorded below the line. Also, an above-the-line adjustment will artificially lower the reported earnings of the carriers, which will critically distort decision making on policy issues both at state and federal levels. Further, an above-the-line adjustment could infer that the carriers' financial depreciation rates are reasonable for regulatory purposes. The NARUC asserts that use of financial depreciation rates should not be taken as tacit approval of the shorter lives. As the Depreciation Order stated, "the incumbent LECs have not sufficiently demonstrated the validity of the assumptions underlying their proposed shorter lives for plant equipment categories other than digital switching equipment."

The below-the-line adjustment provides assurance that customer rates will not be affected by the adjustment. The CALLS ILEC proposal already commits not to change interstate price caps or rates, not to seek recovery of the regulatory-financial book reserve difference in customer rates or through a low-end or exogenous adjustment. While the commitment refers to interstate amortizations, the FNPRM infers that the CALLS ILECS intend to commit not to seek recovery, at the state level, of any portion of the amortization. The NARUC believes that a similar adjustment on the intrastate books of price cap ILECs would bring all plant records in agreement with the financial records and would assure there is no impact on intrastate customer rates.

On the other hand, if the FCC concludes that the amortization should be recorded as an above-the-line operating expense, the NARUC asserts that carriers be required to use Account 6565, Amortization Expense-Other, to record the amortization expense with subsidiary records maintained in accord with the Uniform System of Accounts (USOA). The specific accounting treatment must be mandated to fully insure that no portion of these expenses will impact local rates, UNEs, interconnection rates, or USF cost levels.

The FNPRM requests comment on whether a five-year amortization accounting treatment will have an adverse impact on reported earnings. Without knowing the specific amount of the amortization for the operating carriers, the NARUC cannot categorically conclude that a five-year amortization will or will not have an adverse impact on a carrier's earnings. However, 1999 rates of return reported in the FCC ARMIS reports range from 14% to 24% which indicate little likelihood of an adverse impact either from a five-year amortization period or an immediate write-off. In fact,

based on data currently reported, it appears that the amortization expenses will mainly serve to reduce high reported rates of return for regulatory reporting purposes.

Impact on Local Rates and Competition

A major public interest issue remaining is to determine how the new depreciation rates resulting from the shorter lives and possibly different depreciation methods will affect future costs and customer rates. The FCC currently uses depreciation factors within the FCC authorized ranges when calculating forward-looking economic costs for universal service high cost loop support purposes. The FNPRM does not propose a change to this policy. If the FCC decides to no longer prescribe depreciation rates for price cap ILECs, the NARUC strongly believes the FCC should continue to oversee the adequacy of depreciation in cases where depreciation expense is a significant portion of the cost or price. While there will certainly be more pressure for the FCC and states to use the financial depreciation rates as inputs to the proxy models, the FCC should remain cognizant of its conclusion in the Depreciation Order that the ILECs have not sufficiently demonstrated the validity of the assumptions underlying their proposed shorter lives for plant equipment categories other than digital switching equipment.

Another reason for continued FCC oversight is that carriers may choose other methods of depreciation, such as accelerated depreciation, while maintaining existing financial lives. There is nothing in the FNPRM that would prohibit this action, although the FCC's USOA currently requires carriers to use a straight-line method of depreciation. However, with increased pressures for the

FCC to move to General Accepted Accounting Principles (GAAP), the NARUC cautions the FCC that GAAP would permit the use of depreciation methods other than straight-line. Depreciation rates resulting from accelerated depreciation methods, if used in the proxy models, would have a significant impact in the determination of universal service support as well as interconnection and UNE prices. Additionally, FCC oversight will provide states with an additional source of information that can be considered in determination of prices for unbundled network elements and intrastate universal service fund levels.

Additionally, until the FCC adopts a pure price cap regulatory scheme, the NARUC strongly recommends that the FCC require the carriers to make a showing that there are compelling reasons for depreciation expenses that trigger a low-end adjustment or when carriers seek recovery of depreciation expenses through other mechanisms. Without imposing some standard of review, there is no protection against huge amounts of unregulated depreciation expenses that carriers could use to trigger automatic low-end adjustments and other recovery mechanisms and pass through in consumer rates.

Before rendering a decision in this rulemaking docket, the NARUC believes that the FCC should quantify the overall change that will result from moving to financial depreciation rates, and require each ILEC to furnish the following information:

- The reserve differences at December 31, 1999 between its financial and regulatory books.
- The projected financial depreciation expense for year 2000.

- The projected regulatory depreciation expense for year 2000 with and without the reserve amortization.
- The depreciation method to be used for calculating financial depreciation expense.

Timing and Confidentiality

In order for the FCC to continue its ability to maintain realistic life and salvage factor ranges so they are available for use in universal service cost models or in states interconnection and unbundled network elements (UNE) cost analyses, carriers should be required to submit plant life information to satisfy the fourth criteria set forth in the Depreciation Order. However, the CALLS proposal would place the timing of such data submission at the discretion of the carriers by committing “to submit, under a request for confidentiality, information concerning their depreciation accounts when significant changes to depreciation factors are made.” The NARUC is concerned that insignificant changes to the carriers may not be considered insignificant to the FCC or to the States. The FCC should determine for themselves if changes in depreciation factors are warranted. This can only be done if the relevant information and data is available. Therefore, we strongly urge the Commission to reaffirm its position in the Depreciation Order and require carriers to submit information such as forecast additions and retirements for major network accounts; replacement plans for digital central offices; and information concerning relative investments in fiber and copper cable. This information should be readily available from the carriers’ records whether plant and equipment is depreciated over its service life under financial or regulatory accounting principles and therefore should not be burdensome. Further, we suggest that this information be submitted on an

annual basis. Carriers already submit accounting information annually through the FCC ARMIS Reports. With the rampant technological changes in technology and competitive pressures facing carriers, updated planning should likewise be available annually without causing an undue burden.

Additionally, the FCC has procedures, which dictate the confidentiality of information. The Depreciation Order found the existing procedures to be sufficient to protect carrier information. The NARUC asserts that a conclusion at this time on the confidential status of carrier information to be submitted is premature.

CPR Audits

The FNPRM requests comments regarding whether the CPR audits should be terminated when the ILECs agree to an amortization adjustment. The NARUC believes it is in the public interest and fosters competition to resolve the questions arising from the CPR audits rather than ignoring them, regardless of the outcome of this rulemaking. It is hard to find any rationale in this proceeding that would justify terminating the current CPR proceedings. Those proceedings specifically relate to missing plant assets not to potential changes to existing plant lives and depreciation factors. Further, CPR discrepancies could have an impact on current levels of universal support for rural carriers, since the existing methodology calculates support based on historical financial information. On a forward-looking basis, universal service support for nonrural ILECs may also be affected, to the extent that the proxy model employed utilizes historical relationships to determine forward-looking plant-specific expenses and other expense categories. If intrastate USFs are established, use of erroneous embedded data may result in misstatements of funding requirements, if estimates of expense levels attributable to universal service are based on faulty historical cost relationships. In either event, the reliance on historical costs that are misstated could mean the calculations used to establish an intrastate USF would be inaccurate.

A fundamental concept is that depreciation expenses relate to existing assets regardless of the effect on price caps. It is imperative that the depreciation rate be applied to the correct base in calculating depreciation expense. To the extent the base is overstated due to a carrier's failure to record the retirement of investment that is no longer in service or the inclusion of non-regulated assets, depreciation expenses will be overstated. The FNPRM seems to infer that the proposed amortization will correct any misstatements resulting from the CPR audits. The NARUC asserts that

the amortization action contemplated in this proceeding will not affect the investment to which depreciation rates will be applied. If the investments are overstated before the amortization, they will be overstated after the amortization. The proper valuation of a carrier's assets is imperative in order to assure that funding for high cost loops is determined appropriately. For these reasons, the NARUC believes the FCC should require the ILECs to provide a plan to verify that the plant and equipment being depreciated on the financial records is properly includable in their plant and equipment balances in their financial statements. The issues raised in the CPR proceedings should be thoroughly reviewed and decided in those proceedings and not in this FNPRM.

Additional Comments

The NARUC notes that this FNPRM was released on April 3, yet comments are due by April 17. State commissions, which hold publicly, noticed meetings can barely react in such a brief amount of time. Additionally, states were not provided a sufficient opportunity to be involved in the negotiations that specifically gave rise to this rulemaking. Furthermore, the outcome of this rulemaking should not be a predetermined condition of the CALLS proposal regarding universal service and interstate access charge reform.

IV. Conclusion

In conclusion, the NARUC believes that the proposal of the ILEC members of the CALLS, with minor modification, could satisfy the criteria set forth in the Depreciation Order. However, before the proposal is applied to other price cap ILECs, the FCC should obtain similar commitments as received from the CALLS ILECs. Furthermore, before rendering a decision in this rulemaking docket, the FCC should quantify the overall change that will result from moving to financial depreciation rates for all carriers.

We strongly believe the difference between the financial reserve position and the regulatory reserve position should be recorded as a one-time below-the-line adjustment to ensure there is no customer rate affect. However, if an above-the-line adjustment decision is made, we believe a one-year amortization is appropriate as it does not appear that such action will have an adverse impact on reported earnings.

Additionally, in order for the FCC to update its life and salvage ranges to use when calculating forward-looking economic costs for universal service high cost loop support purposes as well as for states to use for interconnection and UNE prices, carriers should submit plant life information on an annual basis. Finally, questions arising from the CPR audits should be resolved independent of the decision in this rulemaking. The potential impacts on depreciation expense and universal support levels, because of overstated investment levels, have no relation to the amortization amount or the fact that it is non-recoverable.

Lastly, the NARUC is concerned with the unduly short comment time in this rulemaking and with negotiations that have not provided sufficient opportunity for states and the general public to be involved.

Respectfully Submitted:



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